Unexpected dip in UK inflation unlikely to halt a May rate hike

The latest UK inflation data is unlikely to get in the way of a May rate hike, but a further deceleration in core CPI over coming months could prove to be a headache for policymakers later in the year

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For a second month running, UK core inflation has disappointed market expectations and will come as a blow to some Bank of England hawks. Admittedly some of the latest unexpected fall in core CPI to 2.3% can be explained away by quirks. For instance, airfares actually fell in March despite the early Easter – a seasonal pick-up in travel costs was a key reason why many analysts, ourselves included, had looked for a temporary pick-up in inflation today. The fact that the government made no changes to alcohol/tobacco taxation in March (given the move to a November budget) also reportedly weighed on the data.

But fundamentally, core inflation is falling because prices have now virtually adjusted to the post-Brexit plunge in the pound. We can see this most evidently in the prices of currency-sensitive goods like TVs and computers, which are now falling increasingly rapidly. For this reason, we think the only way is down for core inflation and we expect it to be more-or-less back to target by the summer.

At face value, this takes some of the pressure off the Bank of England to tighten policy over coming months. But as we discussed yesterday, wage growth is central to the Bank's thought process when considering inflationary pressures, and the recent data has been surprisingly strong.

> That means a May rate hike still looks like an increasingly done deal, but what comes thereafter is far less clear. Policymakers have appeared to talk up the prospects of a second rate hike later in the year, so a November move certainly shouldn't be ruled out. But Brexit still has the potential to get quite noisy around the time of October's EU summit, while the economy is still struggling to get up to speed. The consumer sector remains a particular source of vulnerability, and we might see further evidence of this in tomorrow's retail sales numbers.

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